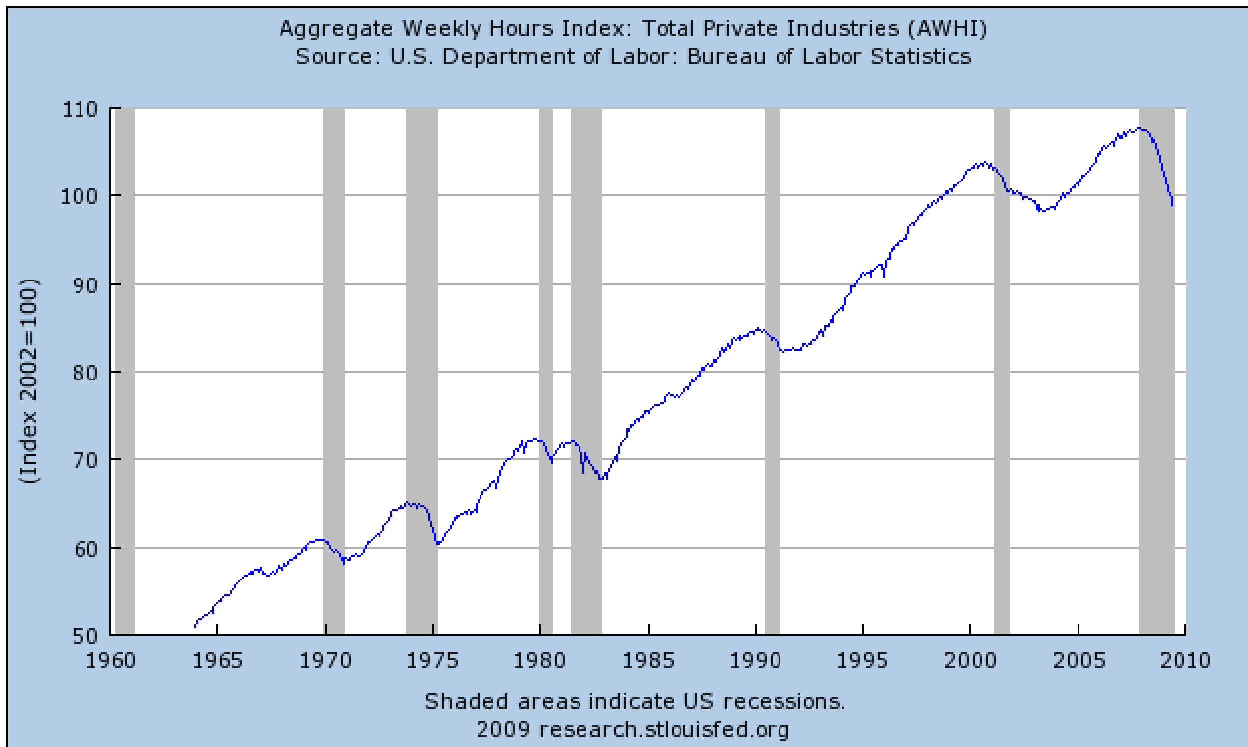
Productivity Gains Point to a Jobless Recovery

August 3, 2009

> "It is noteworthy that the higher-than-forecasted job losses are not associated with substantially weaker-than-expected GDP. Rather, it appears that a given level of output is being produced with fewer people working than historical relationships would suggest."
>
> *– Lawrence H. Summers, Director, National Economic Council*

It should come as no surprise to anyone that this recession has been accompanied by increasing unemployment. What makes this downturn unique is that jobs and workers' hours have been cut much faster than the rate at which the economy has been contracting. While the consequent surge in productivity has been good for corporate earnings, the longer-term implications are far less encouraging. In fact, the dynamics behind these productivity gains suggest continued weakness in the job market for years to come.

The graph below, courtesy of the St. Louis Fed, shows the index of aggregate weekly private-sector hours worked. During the second quarter the index declined at an annual rate of 8.3%, far surpassing the 1.0% rate of GDP contraction reported last Friday. In the first quarter, while the economy shrank at a 6.4% annual rate, hours worked fell at an even-faster 9.2% pace. Overall, the weekly hours-worked index has fallen 8.2% from its peak of 107.8 in December 2007 to 99.0 in June 2009. As labor input has plunged in comparison to economic output, the result has been positive productivity growth in five of the six quarters since the recession began.

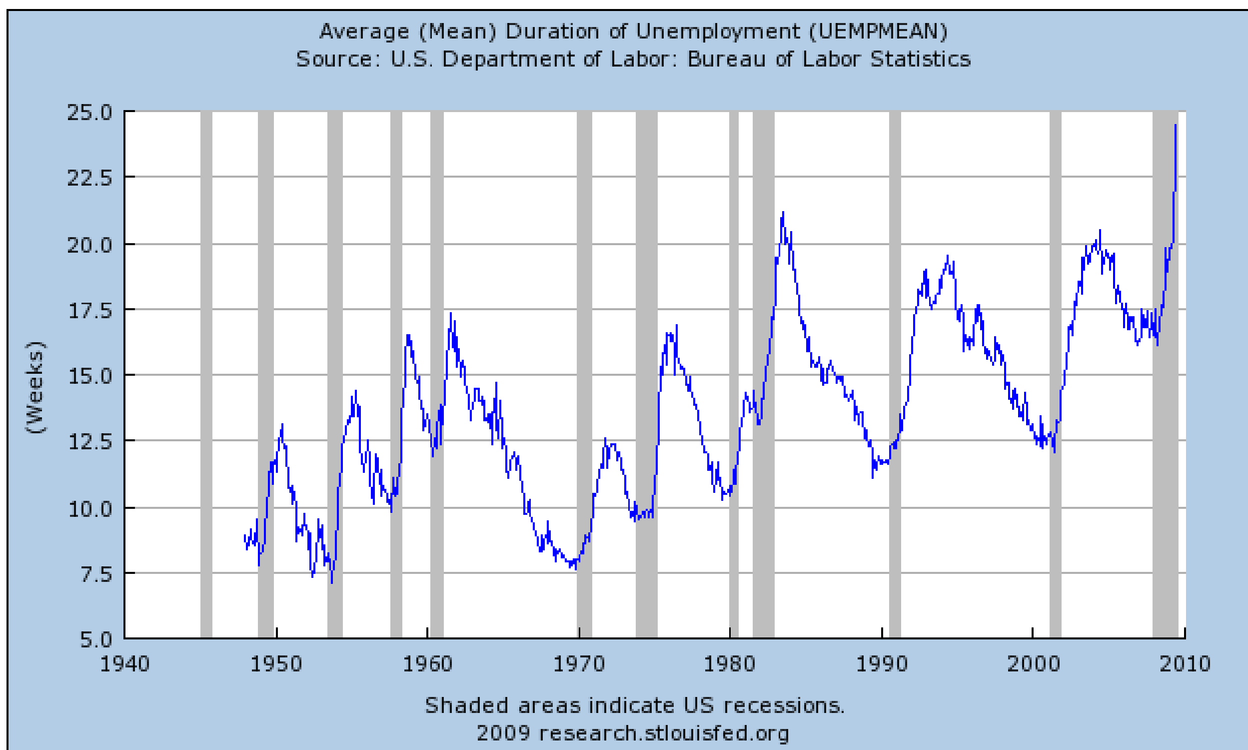


Not Your Typical Recession

Companies ordinarily seek to retain their employees during recessions while waiting for business to improve. The result is a characteristic drop in productivity as output declines faster than labor input. However, that is not what happened this time. Instead, firms have aggressively downsized in order to conserve cash and position themselves for a potentially extended period of difficult business conditions. Moreover, the methods by which this downsizing has been achieved also differ from previous recessions and do not bode well for future job growth.

The first difference is employers have been more inclined to lay off workers permanently rather than temporarily. Since the beginning of the recession, the fraction of workers on temporary layoffs has fallen from 12.7% of total unemployment in December 2007 to 11.9% in June 2009. In a typical recession there instead would have been a significant increase. For example, during the recession of 1981-1982 the share of unemployed workers on temporary layoffs rose from 16.1% to 20.7%. With fewer workers now waiting to be called back to jobs when the economy improves, the unemployed on average will be searching for work longer.

The next graph shows the mean duration of unemployment for those who are jobless. In June the average rose to 24½ weeks, which was the longest since the series began in 1948.



Unfortunately, the longer a person remains unemployed, the less employable he or she generally becomes. Job skills deteriorate and grow outdated over time. Regardless of when this recession ends, the self-perpetuating nature of long-term joblessness will continue to exert upward pressure on the unemployment rate for at least the next several years.

Another discouraging aspect of the current employment situation is the number of workers who are involuntarily employed part-time. The June employment report showed 9 million people working part-time for economic reasons rather than by choice. This is an all-time high and nearly double the 4.7 million people involuntarily employed part-time when the recession began in December 2007. As a fraction of the labor force, those working part-time against their wishes have increased from 3.0% of total in December 2007 to 5.8% of total in June 2009. A full 75% of these workers report their hours were cut back because of slack work conditions, as opposed to those who could only find part-time work to begin with. This is up from 68% of all involuntary part-timers when the recession began.

Elevated levels of involuntary part-time workers will allow employers to increase the hours of existing employees rather than expand their workforces when the economy rebounds. That process, together with large numbers of long-term unemployed, will tend to keep unemployment rates high long after economic recovery is underway.

The Picture

When considering the prospects for recovery, two things should be kept in mind. First, this recession began with weakness in the housing market that gradually escalated into a full-blown financial crisis. Second, housing prices are highly dependent upon people having jobs. So, to the extent that any potential recovery in the economy must include rebounds in both housing and jobs, the notion of a jobless recovery is an oxymoron. If the recovery is all about jobs, the picture appears rather bleak

Such dour considerations appear to be of little worry to investors. The chart on the next page shows the S&P 500 Index blasting off from its 200-day moving average on Monday, July 13 into a rocket-ship rise. This is an exhaustion style of trend that typically would need to show at least some brief consolidation before continuing higher. Supporting that possibility is RSI's push above 70 into overbought territory.

The next corrective move down toward the 50-day moving average could set in an important low. A subsequent move up could set up either a lower high or a failed retest of the previous high. In other words, if this rally is going to fail, then it likely will do so near current levels.

Long-term resistance at 1,008 is only about 20 points away. Overcoming it would provide strong confirmation the bear campaign ended on March 6, 2009 at a cyclical low of 666.79. Under that scenario the current cyclical bull market would face additional resistance at 1,012.66 and at 1,014.14. So, we essentially can expect a six-point band of resistance starting at 1,008.

A second, equally sufficient indication of a cyclical bull market would be if the rally from the March lows were to continue past 180 calendar days. On that measure the S&P 500 Index merely would have to register a new recovery high at some point beyond September 2.

Regardless of whether a cyclical bull market can be demonstrated, we expect the secular bear market that began in March 2000 to include at least one additional bear campaign before running its course. From that standpoint the question of "new bull market" versus "bear-market rally" may prove to be a distinction without a difference.

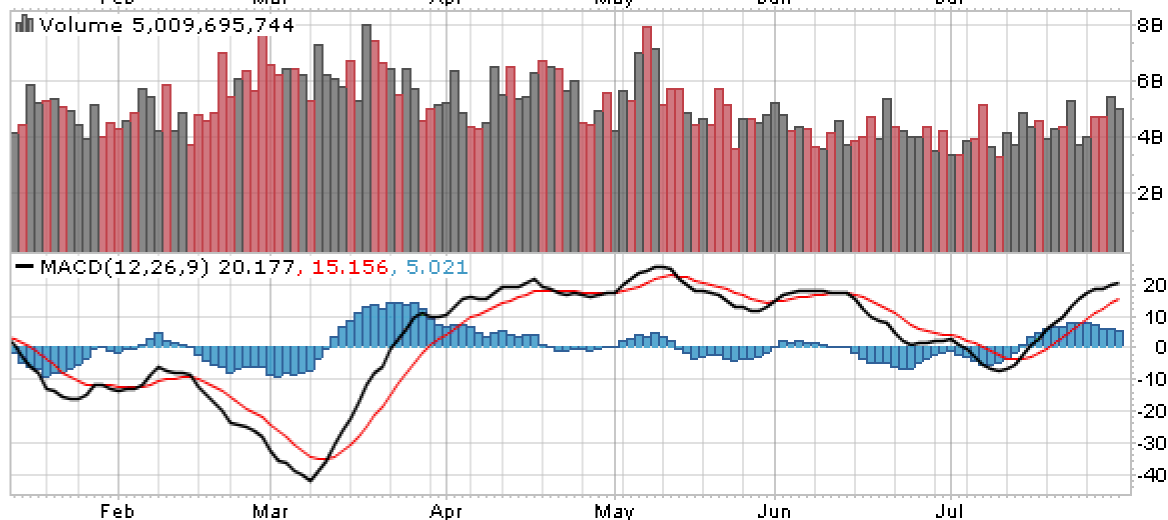


Chart courtesy of StockCharts.com

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